The Management University of Africa

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UNDERGRADUATE UNIVERSITY EXAMINATIONS

SCHOOL OF MANAGEMENT AND LEADERSHIP

DEGREE OF BACHELOR OF ARTS IN DEVELOPMENT STUDIES

BDS 305: MICROFINANCE FOR ENTERPRISE DEVELOPMENT

DATE: 1ST AUGUST 2017

DURATION: 2 HOURS

MAXIMUM MARKS: 70

INSTRUCTIONS:

1. Write your registration number on the answer booklet.
2. **DO NOT** write on this question paper.
3. This paper contains **SIX (6)** questions.
4. Question **ONE** is compulsory.
5. Answer any other **THREE** questions.
6. Question **ONE** carries **25 MARKS** and the rest carry **15 MARKS** each.
7. **Write all your answers in the Examination answer booklet provided.**

QUESTION ONE

Read the Case Study below carefully and answer the questions that follow:

THE IMPORTANCE OF ADEQUATE CASH FLOW AND THE CAPACITY TO SERVICE DEBT

Debt capacity is an important consideration in determining the demand for financial services. When identifying their target market, MFIs must consider clients' and potential clients' cash flow as well as their ability to repay loans. Cash flow is the comparison of cash inflows and outflows. Debt capacity is the amount of additional debt a client can take on without running the risk of inadequate cash flow and consequent loan default. MFIs need to consider *debt capacity* as opposed to basing credit decisions on a "credit need" approach that risks future trouble for both lenders and borrowers. A credit-need assessment yields unreliable information because self-reported credit need involves "wishing." By focusing on credit need rather than debt capacity the lender risks not getting the money back, and the borrower risks serious debt. This is because the need for credit and the ability to repay debt cannot be assumed to match.

No matter how the target market is identified, it is imperative for MFIs to ensure that each client and target group can generate enough cash to repay the loan on time. This in turn determines the *size* of the potential target market (differentiating between "credit need," or what borrowers say they want, and "effective demand," or what borrowers can and are willing to borrow and repay).

"Lenders are able to recover loans on schedule only when the repayment capacity of the borrower equals or exceeds debt service, which consists of principal and interest due for payment. Borrowers are able to repay their loans on time without suffering hardship only when their repayment capacity equals or exceeds the debt service due according to the loan contract. These simple, self-evident relationships define the role that credit plays in development and influence the fate of efforts to expand the frontier of formal finance." (Von Pischke 1991, 277)

To determine potential clients' debt capacity, the first consideration is their cash flow. It is then necessary to assess the degree of risk associated with this cash flow and other claims that may come before repaying the MFI loan. Adjusting the debt capacity of a borrower for risk should reflect reasonable expectations about adverse conditions that may affect the borrower's enterprise.

Adjustment for *adversity* should reflect the lender's willingness to assume the risks of borrowers' inability to repay. The greater the MFI's capacity to assume risk, the higher the credit limits the lender can offer. Other claims that need be considered are debts to other lenders (claims by informal lenders generally rank ahead of those of formal credit institutions) and household expenses such as food and fuel, taxes, school fees, and expenditures for emergencies, important social obligations, and ceremonies. MFIs need to be conservative when estimating the debt capacity of a potential target market, because determining clients' debt capacity is an important part of identifying a target market and designing appropriate products and services for this market. For the most part, borrowers do not go into debt to the full extent of their debt capacity. Economists refer to this as "internal credit rationing." If borrowers attempt to fully exhaust their debt capacity, they are usually behaving opportunistically and are at risk of not being able to manage debt.

Required

a) From the above case highlight reasons why debt capacity is an important consideration in determining the demand for financial services **(8 marks)**

b) Explain reasons given in this case why adjustment for *adversity* should reflect the lender's willingness to assume the risks of borrowers' inability to repay **(9 marks)**

c) Capital/finance is regarded as life blood of any enterprise. Therefore, the significance of working capital in an enterprise lies in the fact that its circulation has to be properly regulated in the business. Discuss three Significance Of Working Capital **(6 marks)**

d) Distinguish between small enterprise and micro-enterprise **(2 marks)**

QUESTION TWO

a) Highlight characteristics of Small & Micro Enterprises **(5 marks)**

b) Microfinance and micro credit has been described as impacting more positively on the enterprises in Kenya. Discuss any five impacts of micro finance to the Kenya's micro enterprises and small businesses **(10 marks)**

QUESTION THREE

a) The psychology belying the use of Joint Group Lending is that empowered groups and community are fundamental in sustainability of the loaning ability and repayment of loans. Highlight the Micro finance utilization of Nine Element cycle of Community Empowerment **(9 marks)**

b) Explain the main challenges facing small and micro enterprises in Kenya giving relevant examples **(6 marks)**

QUESTION FOUR

a) There are many strategies and policies of empowering women and sustain the momentum for the good of the countries of the world. Discuss five strategies **(10 marks)**

b) Highlight the key issues that determine sustainability of microfinance institutions sustainability **(5 marks)**

QUESTION FIVE

a) Define poverty and explain some common strategies and policies of poverty alleviation in Kenya citing examples **(10 marks)**

b) Explain entrepreneurship concept and briefly discuss the role of entrepreneurs in an economy such as Kenya **(5 marks)**

QUESTION SIX

a) Define risk and identify any four sources of risk in financial institutions and projects in other areas **(9 marks)**

b) Identify various ways of managing risk in enterprises and businesses

(6 marks)